Worst Financial Crisis since 1929: The Fed's $1.5 Trillion Stimulus Bill. Long Term Solutions

"Socialism at Its Finest after Fed's Bazooka Fails"

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In what is being called the worst financial crisis since 1929, the US stock market has lost a third of its value in the space of a month, wiping out all of its gains of the last three years. When the Federal Reserve tried to ride to the rescue, it only succeeded in making matters worse. The government then pulled out all the stops. To our staunchly capitalist leaders, socialism is suddenly looking good.

The financial crisis began in late February, when the World Health Organization announced that it was time to prepare for a global pandemic. The Russia-Saudi oil price war added fuel to the flames, causing all three Wall Street indices to fall more than 7 percent on March 9. It was called Black Monday, the worst drop since the Great Recession in 2008; but it would get worse.

On March 12, the Fed announced new capital injections totaling an unprecedented *$1.5 trillion* in the repo market, where banks now borrow to stay afloat. The market responded by driving stocks 8% lower.

On Sunday, March 15, the Fed emptied its bazooka by lowering the fed funds rate nearly to zero and announcing that it would be purchasing $700 billion in assets, including federal securities of all maturities, restarting its quantitative easing program. It also eliminated bank reserve requirements and slashed Interest on Excess Reserves (the interest it pays to banks for parking their cash at the Fed) to 0.10%. The result was to cause the stock market to open on Monday nearly 10% lower. Rather than projecting confidence, the Fed's measures were generating panic.

As financial analyst George Gammon observes, the Fed's massive $1.5 trillion in expanded repo operations had few takers. Why? He says the shortage in the repo market was not in "liquidity" (money available to lend) but in "pristine collateral" (the securities that must be put up for the loans). Pristine collateral consists mainly of short-term Treasury bills. The Fed can inject as much liquidity as it likes, but it cannot create T-bills, something only the Treasury can do. That means the government (which is already $23 trillion in debt) must add *yet more* debt to its balance sheet in order to rescue the repo market that now funds the banks.

The Fed's tools alone are obviously incapable of stemming the bloodletting from the forced shutdown of businesses across the country. Fed chair Jerome Powell admitted as much at his March 15 press conference, stating, "[W]e don't have the tools to reach individuals and particularly small businesses and other businesses and people who may be out of work …. We do think fiscal response is critical." "Fiscal policy" means the administration and

Congress must step up to the plate.

What about using the Fed's "nuclear option" – a "helicopter drop" of money to support people directly? A March 16 article in Axios quoted former Fed senior economist Claudia Sahm:

> The political ramifications of the Fed essentially printing money and giving it to people – there are ways to do it, but the problem is if the Fed does this and Congress still has not passed anything … that would mean the Fed has stepped in and done something that Congress didn't want to do. If they did helicopter money without congressional approval, Congress could, and rightly so, end the Fed.

The government must act first, before the Fed can use its money-printing machine to benefit the people and the economy directly.

The Fed, Congress and the Administration Need to Work as a Team

On March 13, President Trump did act, declaring a national emergency that opened access to as much as $50 billion "for states and territories and localities in our shared fight against this disease." The Dow Jones Industrial Average responded by ending the day up nearly 2,000 points, or 9.4 percent.

The same day, Democratic presidential candidate Rep. Tulsi Gabbard proposed a universal basic income of $1,000 per month for every American for the duration of the crisis. She said,

> "Too much attention has been focused here in Washington on bailing out Wall Street banks and corporate industries as people are making the same old tired argument of how trickle-down economics will eventually help the American people."

Meanwhile the American taxpayer "gets left holding the bag, struggling and getting no help during a time of crisis." H.R. 897, her bill for an emergency UBI, she said was the most simple, direct form of assistance to help weather the storm.

Democratic presidential candidate Andrew Yang, who made a universal basic income the basis of his platform, would go further and continue the monthly payments after the coronavirus threat was over.

CNBC financial analyst Jim Cramer also had expansive ideas. He said on March 12:

> How about a $500 billion Treasury issue … [at] almost no interest cost, to make sure that when people are sick they don't have to go to work, and companies that are in trouble because of that can still make their payroll. How about a credit line backstopped by … the Federal Reserve. I know the Federal Reserve is going to say they can't do that, Congress is going to say they can't do that, everyone is going to say what they said in 2007, they can't do that, they can't do that — until they did it. … [W]e heard all that in 2007 and they ended up doing everything.

And that looks like what will happen this time around. On March 18, as the stock market continued to plummet, the administration released an outline for a *$1 trillion* stimulus bill, including $500 billion in direct payments to Americans, along with bailouts and loans for the airline industry, small businesses, and other "critical" sectors of the U.S. economy.

But the details needed to be hammered out, and even that whopping package buoyed the markets only briefly. In the bond market, yields shot up and values went down, on fears that the flood of government bonds needed to finance this giant stimulus would cause bond values to plummet and the government's funding costs to shoot up.

Extraordinary Measures for Extraordinary Times

There is a way around that problem. To avoid driving the federal debt into the stratosphere, the Treasury could borrow directly from the central bank interest-free, with an agreement that the debt would remain on the Fed's books indefinitely. That approach has been tested in Japan, where it has not generated price inflation as austerity hawks have insisted it would. The Bank of Japan has purchased nearly 50 percent of the government's debt, yet consumer price inflation remains below the BOJ's 2 percent target.

Virtually all money today is simply "monetized" debt – debt turned by banks into something that can be spent in the marketplace – and the ultimate backstop for this sleight of hand is the central bank and the government, which means the taxpayers. To equalize our very unequal system, the central bank and the government need to work together. The Fed needs to be "de-privatized" – turned into a public utility that serves the taxpayers and the economy. As Eric Striker observed in *The Unz Review* on March 13:

> The US government's lack of direct control over the nation's central bank and the plutocratic nature of our weak state means that common sense solutions are off the table. Why doesn't the state buy up majority shares in large corporations (or outright nationalize them, as happened with the short successful experiment with General Motors in 2009) and use the $1.5 trillion at low interest to develop American industrial independence?

Interestingly, that too could be on the table in these extraordinary times. Bloomberg reported on March 19 that Larry Kudlow, the White House's top economic adviser, says the administration may ask for an equity stake (an ownership interest) in corporations that want coronavirus aid from taxpayers. Kudlow noted that when this was done with General Motors in 2008, it turned out to be a good deal for the federal government.

While traditionally considered "anti-capitalist," the government taking an ownership interest in bailed out companies may be the only way the proposed bailouts will get approval. There is little sentiment today for the sort of no-strings-attached "socialism for the rich" that the taxpayers shouldered in 2008 without reaping the benefits. Bloomberg quotes Jeffrey Gundlach, chief executive officer at DoubleLine Capital:

> I don't think government bailouts of over-leveraged companies that got over-leveraged by share buybacks at all-time highs, enriching executives and hedge fund investors, will sit well with the American people.

The Bloomberg article concludes with a quote from another chief investment officer, Chris Zaccarelli of Independent Advisor Alliance:

> I like how [the administration is] thinking a little bit outside of the box. Something big and bold like that could potentially be what turns the market around ….

Long-term Solutions

Rather than just a stake in the profits, the government could think a bit further outside the box and turn insolvent airlines, oil companies, and banks into public utilities. It could require them to serve the people and the economy rather than just maximizing the short-term profits of their shareholders.

Concerning the banks, the Fed could do as the People's Bank of China is doing in this crisis. The state-run PBoC is giving regional banks $79 billion in stimulus money, but it is on condition that they [lend it to small and medium enterprises]() and forgive late payments, so that economic damage is reversed and production can recover quickly.

Another model worth studying is that of Germany, which also has a strong public banking system. As part of a package for coronavirus aid that the German finance minister calls [its "big bazooka,"]() the government is offering immediate access to loans up to €500,000 for small businesses [through its public bank, the KfW]() (Kreditanstalt fuer Wiederaufbau), administered through the publicly-owned Sparkassen and other local banks. The loans are being made available at an interest rate as low as 1%, with interest only for the first two years.

Contrast that to the aid package President Trump announced last week, which will authorize the Small Business Administration to offer business loans. After a lengthy process of approval by state authorities, the loans can be obtained at an interest rate of 3.75% – nearly 4 times the KfW rate. German and Chinese public banks are able to offer rock-bottom interest rates because they have cut out private middlemen and are not driven by the insatiable demand for shareholder profits. They can lend countercyclically to avoid booms and busts while supporting the economy as a whole.

The U.S., too, could create a network of publicly-owned banks backed by the central bank, which could lend into their communities at below-market rates. And this is the time to do it. Times of crisis are when change happens. When the Covid-19 scare has passed, we will have a different government, a different economy and a different financial system. We need to make sure that what we get is an upgrade that works for everyone.

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